

Atlantic City's Luck Runs Out

Jeanine Poggi

03/04/10 - 11:34 AM EST

NEW YORK ([TheStreet](#)) -- Atlantic City offered great promise when it legalized gambling in 1976. The dream was grandiose: the resort town, revitalized by an influx of casinos, would become the "Las Vegas of the East," a glitzy jewel of oceanfront luxury. Today, the reality is a far cry from that fantasy.

[One by one casinos are abandoning the Boardwalk](#), a sentiment being mirrored by the market.

And the feeling of desolation in Atlantic City is palpable. Of the 11 casinos that currently comprise the New Jersey gambling hub, three are in bankruptcy court, and two are on death watch. The other six are either in desperate need of a makeover, recently pulled out of Chapter 11 or in the process of being divested from their owner.

[>> INTERACTIVE TIMELINE: Atlantic City Casinos, Through the Years](#)

[>> INTERACTIVE MAP: Regional Gaming, Dollar by Dollar](#)

Indeed, ever since the casino development boom that energized Atlantic City from the late 1970s until 1990, the city has experienced almost no new development -- save for the much-vaunted Borgata. And while several attempts have been made in recent years to revitalize A.C.'s outdated Boardwalk, all have either been stalled or completely terminated due to the economic climate and increasing competition from nearby markets.

"Atlantic City wasted a 30-year head start," says Dennis Forst, analyst at KeyBanc.

Of course, this steady decline has put a strain on gaming revenue, which had once been a significant and reliable source of income for the beleaguered city. In 2009, gaming revenue dropped 13% to \$3.9 billion, its lowest total since 1994. This was also a 23% plunge from \$5.06 billion peak for gaming revenue in 2006.

For those who wish to own stock in the city, there's hardly anything left to invest in. **Trump Entertainment**, which owns Trump Marina, Trump Taj Mahal and Trump Plaza, is currently battling it out in bankruptcy court. **Harrah's Entertainment**, which owns Showboat, Bally's, Caesars and Harrah's Atlantic City, was taken over by private equity firms back in January 2008. There are murmurs of an initial public offering, but that likely wouldn't occur until 2013 at the earliest.

Like everywhere else, Atlantic City was hit especially hard by the economic downturn. Still, the recession isn't the city's only problem -- and, in fact, might not even be its biggest.

Atlantic City is no stranger to difficult times. According to the 2006-2008 American Community Survey, the most recent such study available, 23.9% of all housing units in Atlantic City were vacant, while the city's unemployment rate was a whopping 12.8%. A shocking 26.3% of all Atlantic City residents live below the poverty line.

Still, since Atlantic City was suffering before the recession and managed its gambling businesses just fine (mostly because the bulk of its customers are actually from the metro New York area), it would be fair to assume the gambling destination might rebound along with the consumer. But the recent [emergence of competing gaming markets](#) in close proximity to the city makes this highly unlikely.

ATLANTIC CITY, SUDDENLY SURROUNDED

Go back 30 years, and there were, of course, really only two gaming markets: Las Vegas and Atlantic City, notes Alex Calderone, who provides turnaround and crisis management services to the gaming sector at Conway MacKenzie. Between 1980 and 1990 only a few more jurisdictions legalized gaming, like Iowa and South Dakota. From 1990 to the present, however, 30 additional states have legalized gaming or implemented tribal gaming.

Pennsylvania, for one, has become the metaphorical thorn in Atlantic City's side. For investors, however, it represents an opportunity to get in on a rapid growth market.

The state introduced slot machines in 2006, and in December, Pennsylvania's slot-machine handle, or how much money people put into the machines, surpassed Atlantic City's for the first time ever.

Earlier this year, Pennsylvania also approved a bill that would allow table games in casinos. Games like blackjack and poker will be implemented in the state at **Penn National Gaming's (PENN)** Hollywood Casino and **Las Vegas Sands' (LVS)** Bethlehem property, as early as this summer.

Sands, for its part, is using this opportunity to turn its Bethlehem casino into a weekend getaway, with plans to restart construction on a 300-room hotel tower next to the casino within the next several weeks.

Beyond that, **Wynn Resorts (WYNN)** announced on Feb. 24 that it is looking to take over the development of a casino project in Philadelphia, entering into a letter of intent with Philadelphia Entertainment and Development Partners. Wynn didn't release the terms of the deal and it still needs to be approved by Pennsylvania regulators, but it is expected to sail through. The project, which will be on the waterfront in Philadelphia, has been called Foxwoods Casino Philadelphia.

While Wynn's move into Pennsylvania will likely pull even more market share from Atlantic City, such a development can also be a catalyst to awaken the sleeping giants on the Boardwalk and stir up some competition, Calderone says.

Also nearby, Delaware passed a bill on Jan. 28 that will allow table games in the state's three racinos. These games will start rolling out in May.

According to Calderone, 30% of Atlantic City's revenue comes from table games, and those table games are an amenity the region has used to differentiate itself. Sharing this business with an additional two markets is expected, again, to expedite a revenue decline for the city.

Moving north along the East Coast, New York's Aqueduct is in the process of adding slot machines to its racetrack. Likewise, in the last 16 months, Maryland and Ohio legalized gambling, and are now looking into legalizing table games. West Virginia also approved table games last year.

CASINOS STEP AWAY FROM THE TABLE

This increase in competition has led numerous casino companies to forgo development in Atlantic City and to look toward other hot markets -- a move that investors might be wise to emulate.

Pinnacle Entertainment (PNK), for example, announced on Feb. 6 that it is abandoning its plans to build a \$1.8 billion casino on the Boardwalk, and subsequently put its 19 acres of land, which was formerly the site of the Sands Atlantic City, up for sale.

Pinnacle purchased the property in 2006 from Carl Icahn for \$270 million. It demolished the casino, but halted development in 2008 because of problems accessing financing.

"Pinnacle realized the last thing AC needs is more competition," Telsey Advisroy Group analyst Chris Jones says.

Just three days after Pinnacle announced it's selling its Atlantic City property, **MGM Mirage (MGM)** revealed plans to divest its 50% stake in Borgata. Last spring, New Jersey regulators deemed MGM's Macau business partner, Pansy Ho, unsuitable, due to claims that her family is involved in Chinese organized crime.

Thus, as MGM prepares for an initial public offering of its Macau asset -- which would strengthen its relationship with Ho -- New Jersey regulators want to hold a hearing regarding the partnership. But CEO Jim Murren has said he wants to put the matter behind him and continue with the growth opportunities in Macau.

MGM is reportedly in talks with casino companies and investors, but has not yet reached a deal. **Boyd Gaming (BYD)**, which owns the other 50% of Borgata, has the right to match any offer MGM receives.

Of course, choosing Macau over Atlantic City is only logical. As Atlantic City tumbled to its lowest gaming revenue in more than a decade, Macau reported a 10% surge in gaming revenue to \$15.1 billion in 2009.

Most casino operators are therefore focusing their attention on the Asian gambling epicenter. Even Harrah's Entertainment, which has extensive holdings in Atlantic City and Las Vegas, wants a stake, purchasing debt of **Melco Crown Entertainment (MPEL)**, which operates solely in Macau.

This is not, however, the first time that MGM has said goodbye to Atlantic City. MGM also squelched its IPO plans back in 2008 amid the economic downturn, for a \$5 billion stake in MGM Grand Atlantic City, which was expected to open in 2012. While the company still holds the property, which resulted in a 73 cent charge in its fourth quarter, there has been no indication that it plans to develop on the land.

The economic downturn has forced other developments to also be stalled or pared back drastically.

AC Gateway, a group headed by former casino executive Wally Barr and Jersey Shore real estate developer Curtis Bashaw,

announced in 2007 that it purchased 10 acres of land next to the Atlantic City Hilton for about \$80 million.

The plan was to build a \$1.8 billion casino project called Atlantic Beach Resort & Casino, but, due to the economy, the group said in February that the project will instead cost between \$200 million and \$300 million.

The biggest focus, however, is on the partially completed Revel development. In 2006 **Morgan Stanley (MS)** purchased 20 acres of land next to the Showboat for \$74 million. It partnered with **Revel Entertainment** to build the \$2 billion Revel Casino.

But difficulty in securing the remaining \$1 billion in financing has caused the opening of Revel to be delayed until 2011. Its massive glass-and-steel exterior, which is the only part that has been completed since construction was halted last year, is a constant reminder of what could be for Atlantic City, but isn't.

ATLANTIC CITY: LONG ODDS, BLEAK FUTURE

It's clear Atlantic City's playing board has been reconfigured, but what will the new Monopoly game look like over the next five years?

"I would be surprised if [Atlantic City] wasn't a whole lot smaller, with only a half a dozen successful casinos," Forst says. "It will be a niche, weekend market."

There most certainly won't be 11 casinos in operation several years from now. Three in particular -- Trump Marina, Resorts and Atlantic City Hilton -- are probable candidates for death row. "The best thing for everyone would be if weaker players shut down," Jones says. "You have to kill a little to get a lot."

The remaining properties, which will most likely be destination casinos like Harrah's Atlantic City, Borgata, Tropicana and Revel (if it ever gets built), will be well-capitalized operators, Calderone says.

Aside from the completion of Revel, it's unlikely investors or casino operators will put any more money into the Atlantic City market. Both Penn National and Las Vegas Sands have said on numerous occasions that they are not interested in expanding into Atlantic City.

The future of Atlantic City could also rest in the hands of two real life Monopoly tycoons: Carl Icahn and Donald Trump.

Trump Entertainment Resorts filed for bankruptcy (its third since the early 1990s) in February 2009. At the time, Donald Trump stepped down as chairman. Shortly thereafter, Icahn purchased a majority of Trump Entertainment's bank debt and teamed up with Texas banker Andy Beal who holds the rest of the Trump loan, proposing to convert the debt into ownership of the company.

Trump came back into the picture, partnering with bondholders who have offered to buy the casinos for \$225 million and give Trump a 10% share in the company for the continued use of his name.

During his testimony in bankruptcy court last week Trump said he is optimistic about a casino comeback and believes his casinos could prosper as the economy recovers despite increasing competition. He said if bondholders gained control they would pump money into the casinos "to make them first-class casinos" and allow them to grow.

If Icahn wins the casinos, according to Trump, he would do nothing to revive Atlantic City. The casinos could become the next Sands Atlantic City, which is now just a desolate lot, if Icahn takes over. This, again, is according to Donald Trump.

Icahn, for his part, has already said that he would consider unloading Trump Marina and Trump Plaza.

Still, there are some favorable factors that might keep operators attracted to Atlantic City. For one, the tax rates are lower there than in neighboring jurisdictions like Pennsylvania and New York, where the tax rate is anywhere from four to five times higher, Calderone says.

And while Atlantic City may no longer be a viable market for growth, experts agree it will always be a gambling destination, if only because it takes a whole lot to revoke a casino license. Likewise, New Jersey lawmakers are looking to legalize sports betting, which could give a boost to casinos, while there are also talks to spruce up and revitalize the decrepit Boardwalk and oceanfront, an attraction neighboring gaming markets don't have.

Then again, the one thing Atlantic City has never lacked is plans -- and dreams.

-- Reported by Jeanine Poggi in New York.

RELATED STORIES:

[>>Atlantic City: Best of Times, Worst of Times](#)

[>>Casino Winners & Losers: Region by Region](#)

Follow TheStreet.com on [Twitter](#) and become a fan on [Facebook](#).